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# Value Added Tax evasion and illegal recovery cases in Lebanon

Rana Ismail<sup>a</sup>\*, Wafic Rihan<sup>b</sup>, Faisal Nsouli<sup>c</sup><sup>a</sup>University Institute of Technology, Lebanese University, Lebanon<sup>b</sup>American University of Science & Technology, Alfred Naccash Avenue – Ashrafieh, Beirut, Lebanon

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## Abstract

In order to increase the treasury's revenues to satisfy the needs of increased expenditures in the public sector, the government is planning to raise the VAT rate two percentage points, an increase that will constitute an additional burden on the consumer's shoulder. A questionnaire is prepared and a qualitative analysis is made in order to detect the ways through which some taxpayers sneak to evade paying the VAT or to unjustly gain money through some illegal recover. To access the aforementioned cases it was imperative to conduct a fieldwork with officials in VAT collection and derivative processes. The two basic references in this respect are the customs authorities and the VAT directorate in the ministry of finance. Solutions are suggested in order to combat VAT evasion to limit as much as possible the waste in the treasury's revenues.

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**Keywords:** Treasury's Revenues , VAT, Illegal Recover, Evasion;

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## 1. Introduction

In this context, and because of the importance of this subject, we decided to delve into the issue of the Value Added Tax, the implementation of its legislations, and process of evading it, in an attempt to safeguard the public money at the same time securing the state's revenues. This research involved shedding light on the legislative gaps and process of evasion and illegal recovery, especially that the gathered data indicated that the Value Added Tax accounted for nearly 25% of the total revenues of the Lebanese State Treasury during the past three years.

## 2. Related Work

This section will discuss publications of some studies that tackled the above-mentioned issue in some European, African and Asian countries. A study published by (Van Brederode, 2008), dealt with tax evasion in some European Union countries, which is considered an issue of growing concern for the financial and fiscal managements in these countries because of its size and frequency, in addition to the difficulty of combating it, since VAT constitutes between 13% and 32% of the total annual revenues in the European Union and is (VAT rate) charged at rates varying between 15% and 25%, depending on the product, service or State. The researcher focused on the Carousel Fraud, involving three parties, and has also studied the position of the third party in these fraudulent transactions.

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\* Corresponding author: Rana Ismail. Tel.: +961 – 70 - 930668  
E-mail address: [rana.ismail87@gmail.com](mailto:rana.ismail87@gmail.com)

After basic description of the design of Carousel Fraud, the researcher took a closer look on the European Union's attempts to combat it, in addition to the latest developments in that respect and the position of the European Court of Justice as to the third party acting in good faith. (Gebauer et al., 2007) published a study in Germany, about tax evasion and methods to control it. In the study, it was stressed that the German State Treasury sustained significant losses due to VAT evasion. They also discussed the newly established reform models, and their ability to reduce the VAT evasion and prevent the decrease in revenues in the European Union. In the course of discussion of the three models of reform, the researchers mentioned that, apart from the usual types of VAT evasion caused by transactions without invoices, input-tax reimbursements based on forged invoices, according to research done by (Merk, 2001; Klawikowski et al., 2002; Wenning, 2002), the so-called Carousel Fraud appears to have recently been playing an important role in the tax revenues.

The researcher (Widman, 2002) explained the reform model, the Preliminary Stage Exemption Model, suggested by Mitler and which refers to the exemption from VAT in trade transactions in their preliminary stages, in addition to the right for deduction for the purpose of controlling tax evasion. This model is applied in all stages of production and sale where the trader has the right for deduction.

A study on the obligation of taxpayers to pay taxes, including VAT, in Nigeria, (Fagbemi et al., 2010) showed that the percentage of tax evasion is clearly influenced by the corruption of the officials and their ability to enforce tax liability. Moreover, the study showed that 90% of the interviewees think that tax evasion is an ethical issue.

A study published by Iglesias and Tavares on the criteria that cause tax evasion in Portugal (Tavares et al., 2010) concluded that two influential factors lead to tax evasion: the confidence in the Fiscal Justice. (Beliefs on justice tax system) and the confidence in the efficiency of tax evasion control. (Beliefs on tax evasion control). It is noteworthy that the study of Iglesias and Tavares (Tavares et al., 2010) was first conducted in Spain and exhibited the same results as those obtained in Portugal. Another study conducted in Turkey (McGee et al., 2011) regarding ethical attitudes to tax evasion, showed similar results to the studies conducted in Nigeria and Portugal, i.e. the rate of tax evasion increases with the increase of corruption of officials and the growth of government squandering, in addition to the lack of belief in the justice of the tax system.

### **3. Research methodology**

VAT evasion and illegal recovery investigation is not easy due to the sensitivity of this topic and the difficulties in obtaining information, as well as the professional confidentiality, the conditions of the administrative work, and the negative stance of some employees in response to this subject.

It was thus imperative to request the consent of the official bodies and to follow a special methodology depending mainly on a field study based on personal interviews (one to one) with officials in Customs Administration and the VAT Directorate in order to deduce the major VAT evasion and illegal recovery cases.

Therefore, we can highlight the main violations and loopholes using non quantitative analysis, conclusions and recommendations concerning the real application of VAT in Lebanon.

As a base of this field study, it was imperative to:

- Search in legal resources and references concerning definitions on the application of VAT and study the related legislations introduced.
- Search in data concerning VAT contribution in the treasury revenues.
- Review studies and publications in many countries concerning the major VAT evasion and illegal recovery cases.

In most interviews honesty and confidence seemed to be predominant in respect to profession ethics.

### **4. Cases of VAT evasion and illegal recovery**

There are multiple cases in Lebanon, we mention:

- a) Declaration of purchased goods with the right to tax deduction where no purchase occurred and no goods actually exist: Issuance of fictitious invoices and right of deduction on fictitious transactions.
- b) Making real transactions, where the trader buys from a supplier and pays the VAT tax to the said supplier. The latter does not declare the sale or remit the VAT collected from the trader. The trader then exercises his right of recovery: Suppliers hiding undeclared business transactions and not remitting illegally charged VAT.
- c) Misclassification of commodities to benefit from exemptions at import to evade VAT tax.
- d) Falsification of the substance of invoices - value or number at import - to avoid paying part of the VAT.
- e) Falsification of the declaration of goods at import - value or number or kind- and re-export, to unlawfully recover higher VAT upon export.

## 5. Proposed Solutions

We proposed several solutions:

- a- It is vital, in the procedures of studying files of deductions application, to follow procedures that prove the actual occurrence of the trading operation.
- b- It is important to conduct field inspection to verify that the trade operation has actually taken place, and to check if double account and invoices exist. This contributes in obliging the institution to adopt new and modern information system for the stock.
- c- The Risk Management System puts between 70% to 80% of the operations in the Green Path, ("NAJM" system) and limits the operations of inspection at a customs check point of intense activity (e.g. Beirut Port). Yet, in the framework of later control, rapid and sudden field inspection programs can be put to detect these cases (opposite detection), in addition to field inspection of the kind of trading activity of the importing institution and its operations with other institutions (the way declared goods are sold and to whom). In the context of field verification, examination of the store accounts, and sales invoices takes place.
- d- In some of the cases, exploiting some of the exemptions stated by laws takes place (furniture for personal use, cars for the handicapped, goods, necessities....). Many cases of evasions were recorded in this context and the content of the declaration of the exempted request cannot be relied on; in addition, office studying or inspecting its documents is not sufficient, but it is essential to:
  - Detecting the goods and requesting documents related to the address of residence of the concerned person, his job, his familial status.... and making an information form for the person to refer to when he performs other operations in his name so as to check the frequency of his using the same right of exemption.
  - Putting field inspection programs on the premises of the concerned address of residence according to the size and kind of the required exemption, especially those of the importers who are eminent taxpayers.
  - Training inspectors and examiners to study that the extent of the exempted goods declared for personal use match the real field state of the person (residence, work, familial status in and outside Lebanon...)
- e- A suggestion to incorporate codes in export procedures. Every person subject to tax and who requests VAT recovery has to include a code in the declaration statement similar to that found in the Customs Law that obliges every person who wishes to benefit from a favored treatment or reduced duty to include a code in the statement. Accordingly, the trader enters the code and the automation system directs it to the mandatory Red Path. This does not constitute a problem in exportation since the number of statements in this case is limited (about 40 statements a day in Beirut Port). If all statements are Red Path it becomes possible to detect them and perform the required verifications, (of the kind, value, and amount of goods). In the framework of this procedure, i.e., using a specific code in the declaration statement in case of recovery request, and after the mandatory detection is complete; the data is entered

into the computer and uploaded on the site of the means of transport (ship or plane). When the VAT Directorate receives the recovery request, it has to confirm, through the link that connects it with the custom's information system that the goods have actually been transported.

## 6. Conclusion:

This research is a step in a corrective, administrative, financial and organizational stage. It is required to reconsider and delve into a number of legislative texts concerning VAT. In addition, this study must be continued in a quantitative and qualitative context in order to discover the lost and wasted money, and therefore, figure out the possible real contribution of this tax in the Lebanese treasury.

In the course of our analysis of the VAT tax evasion cases, the following suggestions are offered to combat these phenomena, or at least, to try to reduce them:

- Revision and reform of all the articles, sections and provisions of the legislation on Value Added Tax to avoid any uncertainty or ambiguity, and to fill the gaps through which illegal transactions are carried out, resulting in substantial losses to the Treasury.
- Reinforcing the tax administration with highly efficient and sufficient human resources as well as highly developed technical means, while emphasizing the need for a better coordination between the concerned administrations.
- The implementation of rules and regulations defining the proper mechanisms to activate control, inspections and audit in the offices and on the field, to reduce VAT tax evasion and illegal recovery.

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